

IRS Calls it Quits on Taxing Some Employee Cell Phones

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The Internal Revenue Service has long maintained that when an employer-provided cell phone is used for personal use, the value of the personal use represents *taxable income* to the employee. While this position may have made sense back when cell phones were first introduced, “the passage of time, advances in technology, and the nature of communication in the modern workplace” rendered the IRS position obsolete.¹ As a result, the IRS issued Notice 2011-72 which states that employers can provide cell phones to employees on a nontaxable basis as long as the cell phone is provided for primarily noncompensatory business reasons.

Employer-provided cell phones are classified as *fringe benefits* under the Tax Code. This means that the value of the fringe benefit (i.e., the cost of a cell phone and cell phone plan) are included in an employee’s gross income unless an exception applies. When cell phones were first introduced, the IRS took the position that business use of an employer-provided cell phone qualified for an exception, but that personal use did not. Consequently, employers who permitted employees to use employer-provided phones for business and personal use were required to report the value of the personal use as gross income on the employees’ W-2.

Notice 2011-72 (the “Notice”) represents a significant shift by the IRS in its treatment of cell phone expenses. The Notice provides that if an employer provides an employee with a cell phone primarily for “noncompensatory business purposes,” the employee’s use of the cell phone for personal reasons will now be treated as de minimis and excluded from the employee’s gross income. Examples of noncompensatory business purposes include employers who need to contact employees at all times for work-related emergencies, or employers who require their employees to

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¹ <http://www.irs.gov/newsroom/article/0,,id=209795,00.html>

be available to speak with clients at times when the employees are away from the office. If a cell phone is not provided primarily for a noncompensatory business purpose, the employee's personal use of the cell phone would be subject to taxation under the rules.

At the same time the Notice was issued, the IRS also released a Field Memorandum ("Field Memo") for use by its field auditors. The Field Memo addresses the related situation in which an employee uses his or her personal cell phones for business use and then is reimbursed by his or her employer for the value of the business use. Using the same "noncompensatory business purposes" test set forth in the Notice, the Field Memo states that if the employer has a substantial business reason for requiring employees to use their personal cell phones for business, the amounts reimbursed to the employees should generally be excluded from the employee's gross income.

Action Points: ■ Employers who provide employees with cell phones should review their policy to make sure there are substantial business reasons for doing so and document the reasons. ■ Employers who reimburse employees for the value of the business use of the employees' cell phones should review their policy to make sure there are substantial business reasons for doing so and document the reasons. In addition, employers should also review their policy to make sure procedures are in place to prevent employer reimbursements from exceeding the employee's actual cell phone costs. ■ Employers who provide cell phones to employees or provide reimbursement for cell phone use, and lack a written policy regarding cell phones, should consider implementing one.

For further information on the tax treatment of cell phones, or for assistance in drafting and reviewing cell phone policies, please contact the author or any member of the Rembolt Ludtke's Employment/Labor Law or Tax Law practice groups.



Ben Moore is an associate with the Lincoln-based law firm of Rembolt Ludtke LLP and may be reached at (402) 475-5100 or bmoore@remboltlawfirm.com. This article is provided for general information purposes only and should not be construed as legal advice. Those requiring legal advice are encouraged to consult with their attorney. In accordance with IRS Circular 230, the discussion of tax matters contained herein is not intended to be used or relied upon by any taxpayer for the purpose of avoiding any penalties that may be imposed under Federal laws; and nothing contained in this message may be used to recommend, promote or market any federal tax transaction or matter.